

Message Text

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PAGE 01 OTTAWA 01452 132117Z

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ACTION EB-11

INFO OCT-01 EUR-25 ISO-00 SP-03 AID-20 NSC-07 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 PA-04

PRS-01 USIA-15 ABF-01 FSE-00 CIAE-00 COME-00 FRB-02

INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06 SIL-01 DRC-01

/161 W

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P 132041Z MAY 74

FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC PRIORITY 3457

UNCLAS OTTAWA 1452

E.O. 11652: N/A

TAGS: EFIN CA

SUBJECT: BANK RATE RAISED AGAIN TO 8.75 PERCENT

REF: OTTAWA 1068

BANK OF CANADA GOVERNOR GENERAL K. BOUEY ANNOUNCED SUNDAY MAY 12 THAT, EFFECTIVE MAY 13, BANK RATE WOULD BE INCREASED ONE-HALF POINT TO RECORD LEVEL OF 8.75 PERCENT. THIS IS SEVENTH INCREASE SINCE APRIL 1973 WHEN BANK RATE BEGAN TO RISE FROM 4.75 PERCENT. (BANK OF CANADA MOVE FOLLOWED ACTIONS BY MOST CHARTERED BANKS LAST WEK TO UP PRIME LENDING RATES TO 11 PERCENT, ACTIONS JUSTIFIED ON GROUNDS THAT LOAN DEMAND STILL STRONG AND COST OF FUNDS TO MEET THIS DEMAND WAS RISING). BOUEY ANNOUNCED AT SAME TIME CHANGE IN METHOD OF DETERMINING MAXIMUM PRA RATE, I.E. RATE AT WHICH BANK OF CANADA IS PREPARED TO ENTER INTO PURCHASE AND RESALE AGREEMENTS WITH MONEY MARKET DEALERS. TEXT OF BANK OF CANADA PRESS STATEMENT EXPLAINING REASONS FOR BANK'S ACTION FOLLOWS:

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PAGE 02 OTTAWA 01452 132117Z

BEGIN VERBATIM TEXT: THE BANK OF CANADA
ANNOUNCED TONIGHT THAT THE BANK RATE HAS BEEN
INCREASED BY 1/2 PERCENT TO 8 3/4 PERCENT
EFFECTIVE MAY 13, 1974. THE BANK RATE HAD BEEN
SET AT 8 1/4 PERCENT ON APRIL 15, 1974.

THE GOVERNOR OF THE BANK OF CANADA, MR. GERALD
K. BOUEY, NOTED THAT A FURTHER UPWARD ADJUSTMENT
OF SHORT-TERM INTEREST RATES IN CANADA HAS OCCURRED
IN RECENT WEEKS, IN PART REFLECTING FURTHER INCREASES
IN SHORT-TERM INTEREST RATES IN THE UNITED STATES
AND IN THE EURO-DOLLAR MARKET. DURING THE SAME
PERIOD, THE PACE OF MONETARY AND BANK CREDIT
EXPANSION IN CANADA HAS BEEN MUCH MORE RAPID THAN
NEEDED TO SUSTAIN THE CONTINUED EXPANSION OF THE
ECONOMY. ALTHOUGH TEMPORARY INFLUENCES INCLUDING
THE RECENT INTERRUPTION OF MAIL SERVICE PROVIDED
A PARTIAL EXPLANATION FOR THE RECENT VERY HIGH RATES
OF MONETARY AND BANK CREDIT EXPANSION, THERE WAS NO
DOUBT THAT THEY ALSO REFLECTED THE CONTINUING INTENSITY
OF UNDERLYING CREDIT DEMANDS IN CANADA. IN THESE
CIRCUMSTANCES NO RESPONSIBLE COURSE OF ACTION WAS OPEN
TO THE BANK OF CANADA WHICH COULD HAVE PREVENTED
THIS LATEST RISE IN SHORT-TERM INTEREST RATES,
AND ACCORDINGLY THE BANK RATE HAS BEEN INCREASED.

THE BANK OF CANADA ALSO ANNOUNCED A CHANGE
IN ITS PRACTICE WITH RESPECT TO THE MAXIMUM RATE
AT WHICH THE BANK IS PREPARED TO ENTER INTO
PURCHASE AND RESALE AGREEMENTS WITH MONEY MARKET
DEALERS. THE PRACTICE HAS BEEN TO SET THE PRA
RATE AT 1/4 OF ONE PERCENT ABOVE THE AVERAGE 91-DAY
TREASURY BILL RATE AT THE LATEST WEEKLY TENDER,
SUBJECT TO A MINIMUM OF BANK RATE MINUS 3/4 OF
ONE PERCENT AND A MAXIMUM OF BANK RATE. HENCEFORTH,
THE MAXIMUM PRA RATE WILL BE BANK RATE PLUS 1/2
OF ONE PERCENT. ALL OTHER EXISTING ARRANGEMENTS
CONCERNING PURCHASE AND RESALE AGREEMENTS REMAIN
UNCHANGED.

UNCLASSIFIED

UNCLASSIFIED

PAGE 03 OTTAWA 01452 132117Z

IN COMMENTING ON THE CHANGE IN THE MAXIMUM
PRA RATE, THE GOVERNOR NOTED THAT IT WOULD PERMIT
MORE FLEXIBILITY IN THE RELATIONSHIP BETWEEN THE
AVERAGE RATE ON 91-DAY TREASURY BILLS AT THE
WEEKLY TENDER AND THE BANK RATE. IN THE PAST THE
BANK OF CANADA'S PRACTICE HAS BEEN SUCH THAT WHEN
THE AVERAGE BILL RATE MOVED UP CLOSE TO THE BANK
RATE (AND THUS TO THE MAXIMUM PRA RATE) EXPECTATIONS

OF AN IMMINENT UPWARD REVISION OF THE BANK RATE WERE GENERATED IN FINANCIAL MARKETS. IF THE BANK REGARDED AN INCREASE IN THE BANK RATE AS APPROPRIATE AT THAT TIME, THIS CREATED NO PROBLEM. IF, HOWEVER, THE BANK DID NOT REGARD AN INCREASE IN THE BANK RATE AS APPROPRIATE, IT FELT OBLIGED TO KEEP THE AVERAGE BILL RATE FROM RISING ABOVE THE BANK RATE, EVEN TEMPORARILY. ON OCCASION THIS HAD INVOLVED THE BANK IN PROVIDING HEAVY SUPPORT TO THE BILL MARKET, THUS COMPLICATING THE TASK OF MANAGING THE CASH RESERVES OF THE BANKING SYSTEM. HENCEFORTH, AN AVERAGE YEILD AT TENDER ON 91-DAY BILLS THAT EQUALS OR EXCEEDS THE BANK RATE OR EVEN THE MAXIMUM PRA RATE SHOULD NOT NECESSARILY BE REGARDED AS FORESHADOWING A CHANGE IN THESE RATES.

THE GOVERNOR NOTED THAT THE BANK RATE WILL CONTINUE TO BE THE MINIMUM RATE FOR LIMITED AMOUNTS OF VERY SHORT-TERM ADVANCES TO THE CHARTERED BANKS. END VERBATIM TEXT.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC GROWTH, CREDIT CONTROLS, PRIME INTEREST RATES
Control Number: n/a
Copy: SINGLE
Draft Date: 13 MAY 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Authority: n/a
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 JAN 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974OTTAWA01452
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D740117-0320
From: OTTAWA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19740553/aaaabuth.tel
Line Count: 136
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EB
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: OTTAWA 1068
Review Action: RELEASED, APPROVED
Review Authority: elyme
Review Comment: n/a
Review Content Flags:
Review Date: 01 NOV 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <01 NOV 2002 by garlanwa>; APPROVED <07 JAN 2003 by elyme>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: BANK RATE RAISED AGAIN TO 8.75 PERCENT
TAGS: EFIN, CA, (BOUEY, GERALD K)
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005